Vol 311

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1940.

No. 490

INTERNATIONAL COMPANY OF ST. LOUIS, a Corporation,
Petitioner,

vs.

E. R. SLOAN, Receiver of The Federal Reserve Life Insurance Company, a Corporation, and OCCIDENTAL LIFE INSURANCE COMPANY, a Corporation.

PETITION FOR WRIT OF CERTIORARI
To the United States Circuit Court of Appeals for the Tenth Circuit

and

SUPPORTING BRIEF.

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PETITION FOR WRIT OF CERTIORARI

To the United States Circuit Court of Appeals For the Tenth Circuit.

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Now comes International Company of St. Louis, a corporation, petitioner, and respectfully petitions this Honorable Court to grant a writ of certiorari to the United States Circuit Court of Appeals for the Tenth Circuit, and to remove therefrom to this court, for review, the record in the case lately pending in said Circuit Court of Appeals styled International Company of St. Louis, a corporation, appellant, v. E. R. Sloan, Receiver of The Federal Reserve

Life Insurance Company, a corporation, and Occidental Life Insurance Company, a corporation, appellees, being cause No. 2006 on the docket of said Circuit Court of Appeals. The duly certified record, including all the proceedings in the District Court of the United States for the District of Kansas, where said cause was heard, and in the said Circuit Court of Appeals, to which an appeal was taken by petitioner from the judgment of the trial court, is filed herewith under separate cover.

Your petitioner represents that it is aggrieved by the decision and judgment of said Circuit Court of Appeals in said cause wherein said Circuit Court of Appeals on July 12, 1940, affirmed the judgment of the trial court, and on August 12, 1940, thereafter denied this petitioner's petition for a rehearing of said cause.

Your petitioner states that the opinion to be reviewed is in conflict with prior opinions of this Court and with prior opinions rendered by the Circuit Court of Appeals of the Tenth Circuit itself and other courts of appeals on the propositions of general law therein announced, and that the matters of issue in said cause are of peculiar gravity and great general importance in that the following are the principal questions presented:

QUESTIONS PRESENTED.

1. Under what circumstances does a person advancing money to a corporation, under a written contract for its repayment, become a stockholder of the corporation, and under what circumstances is such person to be regarded as a creditor?

2. Where a life insurance company, in order to restore its reserve fund held for the benefit of its policyholders, borrows money upon a written agreement that the money

so borrowed, together with interest at 6 per cent, shall be repaid by the company only out of net surplus gains of the company in excess of $50,000.00, and where the agreement further provides that in the event of a reinsurance of the business of the borrowing company the reinsuring company shall be bound each six months to pay the savings and profits arising out of the reinsured business to the lender or its assigns until the principal and interest have been paid, and where the company, without discharging this obligation, becomes again insolvent and a receiver is appointed and the insurance business of the insolvent company is reinsured under a contract of reinsurance entered into by the Receiver under order of the Court with another insurance company, and where, at the time the reinsurance contract is entered into, both the Court and the Receiver and the reinsuring company had knowledge that the money so borrowed had not been repaid; can the provision in the agreement under which the money was advanced to the effect that the reinsuring company shall be bound to repay it out of savings and profits of the reinsured business be disregarded, after such savings and profits are in fact realized, upon the theory that the lender and holder of the certificate occupies a position analogous to a stockholder and is entitled to repayment of the money advanced only after all other creditors have been satisfied?

3. It being recognized as true that the reserve fund of a life insurance company is a trust fund created for the benefit of its policyholders and that future savings and profits of a life insurance business constitute no part of such fund, and are potential assets of the corporation itself, can a life insurance company, for the purpose of borrowing money for restoring an impairment in its reserve, make a valid pledge of the future savings and profits of its insurance business consisting of excess inter-

est earnings, if any, profits on lapses, mortality savings and cash surrender charges, which pledge will be binding upon a future reinsurer of the business in insolvency proceedings who acquires such business under a reinsurance contract ordered and approved by the Court, when the reinsurer takes over the business with notice and knowledge of the existence of such outstanding contract and pledge of the insolvent insurance corporation?

4. Where the terms of such a contract are certain and definite as to the obligation of the reinsuring company in the event of a reinsurance of the business of the original obligor, can the Court properly interpolate words into the contract so as to limit the obligation and hold that, under the provisions of such contract in accordance with which the money was advanced, only a voluntary reinsurance was contemplated by the parties and that such provision as to the obligation of the reinsuring company had no reference to reinsurance of the business of an insolvent company in receivership proceedings?

5. Where a contract in the form of a certificate setting forth the obligation of an insurance corporation to repay money borrowed is prepared, issued and signed by the corporation and where it contains limitations upon the obligation therein set forth for the repayment of the money borrowed, is it in accordance with the recognized rules of construction to construe such contract most favorably to the borrower and interpolate qualifying words so as to impose further limitations, not set forth in the contract itself, on the obligation of the borrower or the reinsurer of its business to repay the money borrowed with a resulting holding that the obligation refers only to a voluntary reinsurance, though the contract itself provides for repayment of the money in the event of any reinsurance?

6. Can the interpretation placed upon a written contract

after its execution by only one of the parties, to wit, the obligor, in a contract for the payment of money, as shown by the method in which it keeps its books, be properly considered in determining the extent of the obligation imposed by the contract?

SUMMARY STATEMENT OF MATTER INVOLVED.

A brief and comprehensive statement of the matter involved is set forth in the opinion in this cause of the Court of Appeals for the Tenth Circuit (R. p. 182) as follows:

"The material facts are not in controversy. The Federal Reserve Life Insurance Company, organized under the laws of Kansas, hereinafter called Federal Reserve, was engaged in the life insurance business in Kansas, Missouri and Indiana; Insurance Investment Corporation, having its principal place of business in Saint Louis, Missouri, was engaged in the business of buying and selling and otherwise dealing in stocks of insurance companies; and the Reserve Company, with its principal place of business in Kansas City, Missouri, was likewise engaged in the business of buying and selling and otherwise dealing in stocks of insurance companies. In 1929, Federal Reserve had outstanding 30,000 shares of capital stock of the par value of $10.00 each, of which Insurance Investment Corporation and the Reserve Company owned 5683 and 8800 shares, respectively. During that year the Insurance Commissioner of Kansas examined the affairs of Federal Reserve and made a report in which its financial condition was criticized and an impairment of capital and reserves was asserted. To meet that situation, Insurance Investment Corporation made an agreement with Fire Insurance Company of Chicago to advance to Federal Reserve, on behalf of Fire Insurance Company, $300,000 and to take therefor a participating certificate, and to sell to Fire Insurance

Company a majority of the outstanding shares of stock of the Federal Reserve. Pursuant to such agreement, Insurance Investment Corporation, on November 18, 1929, advanced to Federal Reserve $300,000 and received therefor the participating certificate which contained these provisions:

" 'For Value Received, The Federal Reserve Life Insurance Company, a Kansas Corporation (hereinafter called the "Company"), hereby promises to pay to Insurance Investment Corporation, a Delaware corporation, or its assigns, the sum of Three Hundred Thousand Dollars ($300,000.00), together with interest thereon from the date hereof at the rate of six per cent (6%) per annum, payable semi-annually, out of a fund to be created by the company setting aside semi-annually on the 30th day of June and the 31st day of December, all net surplus gains in excess of Fifty Thousand Dollars ($50,000.00) until all principal and interest due under this obligation is fully paid. Net surplus gains in excess of Fifty Thousand Dollars ($50,000.00) shall mean that if at any time the Company has a net free surplus of Fifty Thousand Dollars ($50,000.00) that all moneys in excess of that sum shall be paid into the fund above specified.

" 'The obligation of the Company hereunder is a contingent liability, not an absolute promise to pay, but is limited to its firm obligation and covenant to apply the said surplus gains to the making of the payments herein provided for and is not an obligation to be paid out of the general assets of the Company other than the fund mentioned in this certificate.

" 'In the event of a reinsurance of the business of The Federal Reserve Life Insurance Company the reinsuring company shall be bound each six (6) months to pay the savings and profits arising out of the reinsured business (less such part of such savings and profits as may be payable under prior contracts to other persons or corporations) to the then holder or holders of this certificate or any certificate or certifi-

cates issued in lieu of this certificate until the full balance of interest and principal due thereon shall have been paid.'

"On the same day, and for a valuable consideration, Insurance Investment Corporation assigned and delivered such certificate to Fire Insurance Company, and also assigned and delivered or caused to be assigned and delivered, to Fire Insurance Company, 15,100 shares of the capital stock of Federal Reserve, including its own shares and those held by the Reserve Company. Claimant subsequently acquired and owns the certificate, on which no part of the principal or interest has been paid.

"In 1935, a stockholder and policyholder of Federal Reserve instituted this proceeding in equity in the United States Court for Kansas and prayed for the appointment of a liquidating receiver. The receiver and Occidental Life Insurance Company, hereinafter called Occidental, entered into a contract dated June 13, 1936, which provided, among other things, that subject to the terms and conditions therein specified, and not otherwise, Occidental should reinsure and assume the liability of Federal Reserve under its contracts of insurance which were in force and effect on May 22; that coincident with the approval of the contract, title to all of the assets of Federal Reserve should vest in Occidental; that since such assets at their then value were insufficient in amount to cover the reserve liabilities, a lien of fifty per cent of the net equity should be placed against each policy thus reinsured, with provision that the lien should be adjusted at the times and in the manner therein specified, but in no event should it exceed fifty per cent of such net equity; that all assets conveyed, together with all net gains and profits from the business reinsured and from the assets administered by Occidental, should be covered into a separate fund called Federal Reserve Fund; that such fund should be kept in a

separate bank account or accounts and that no investment should be acquired with such fund except with the consent and approval of the court; and that Occidental should furnish the court an annual accounting of such fund as long as the lien should exist against the policies, but in no event after June 30, 1951. At no time subsequent to the execution and delivery of the certificate did the books and records of Federal Reserve, or reports or statements published or filed with the insurance department of any state in which it was licensed to do business show or include such certificate as a liability. Occidental had knowledge at the time of the execution of the contract of the existence of such certificate and of claimant's asserted ownership of it. [The decree and reinsurance contract are set out at R. pp. 33-61.] The court approved the contract and authorized its consummation. Occidental assumed its liability under the contracts of insurance; the receiver transferred, conveyed and delivered the assets to Occidental; the special fund was created; and the contract has been carried out according to its terms. With the money advanced by Insurance Investment Corporation, in the manner outlined, Federal Reserve purchased from a bank a certificate of deposit which was deposited with the Commissioner of Insurance of Indiana as a part of its reserve supporting its outstanding policies of insurance in that state. A substantial part of the money was subsequently loaned, the notes and mortgages received therefor were deposited with the Commissioner of Insurance of Indiana, and they subsequently became a part of Federal Reserve Fund. On May 22, 1936, the total amount of required reserve on all policies issued or assumed by Federal Reserve exceeded $7,500,000, and according to an appraisement made after the approval of the contract, the value of all its assets as of that date was $5,115,738.68. The lien imposed against the net equities of the policies assumed by Occidental, as of such date, amounted to $2,718,120.72; after the applica-

tion of such lien, the surplus funds amounted to $172,511.67; by order of the court surplus, or such part of it as might be necessary, was reserved for the payment of receivership expenses; and the expenses of the receivership to December 31, 1938, amounting to $157,896.55, were paid by the receiver with funds furnished to him from the Federal Reserve Fund.

"Claimant pleaded upon information and belief that profits arising out of the reinsured business of Federal Reserve in excess of $200,000 had accrued and that profits were constantly and continuously accruing; and it prayed that it be adjudged entitled to a lien upon all such profits superior to that of the policyholders or other parties to the suit. The court disallowed the claim and the appeal is from that judgment."

To this we add that the reinsuring company assumed no obligation under the reinsurance contract to pay moneys out of its own funds, the contract providing that the reinsuring company, the Occidental Life Insurance Company, should be reimbursed out of the Federal Reserve fund for any moneys paid on account of the business reinsured which was properly chargeable to that fund (R. pp. 51-2).

The reinsurance contract also provided that the savings and profits of the reinsured business should be applied annually to the reduction of the lien placed by the decree of the Court and the reinsurance contract on the policies constituting the reinsured business until June 30, 1951. After that date the reinsured business becomes completely merged in that of the reinsurer and the requirement as to the maintenance of a separate fund is discontinued (R. p. 52).

The Court held invalid the contract provision that the savings and profits of the reinsured business should be applied to the repayment of the $300,000.00 advanced as

provided in the participating certificate, and upheld the decree of the lower court to the effect that such savings and profits for a stated period should be applied for the benefit of policyholders of the Federal Reserve and thereafter for the benefit of the Occidental Life Insurance Company resulting in the total exclusion of any claim on the part of the holder of the certificate to repayment of the money advanced.

The judgment denying the claim of the International Company of St. Louis was rendered by the District Court of the United States for the District of Kansas on the 28th day of June, 1939 (R. pp. 174-176).

On the 12th day of July, 1940, after due submission to the United States Circuit Court of Appeals for the Tenth Circuit, said Court rendered its opinion and judgment upon the petitioner's said appeal (R. p. 189), affirming the said judgment and decision of the said District Court.

Thereafter, on the 5th day of August, 1940, petitioner duly filed its petition for rehearing in said cause in said Circuit Court of Appeals (R. p. 202). Said petition for rehearing was denied on the 19th day of August, 1940 (R. p. 202).

REASONS RELIED ON FOR ALLOWANCE OF THE WRIT.

I.

The decision of the Circuit Court of Appeals for the Tenth Circuit denying the petitioner's claim for repayment of $300,000.00 advanced to The Federal Reserve Life Insurance Company is based primarily upon the proposition that under the terms of the certificate providing for repayment of the money advanced the payee or holder thereof occupies a position analogous to a stockholder and is,

therefore, not entitled to the benefit of the security provided for in the certificate to the prejudice of the claims of creditors of the corporation. The question as to the proper test for determining whether a person advancing money to a corporation is a creditor or is entitled only to the rights of a stockholder is an important question of general law which has not been, but should be, settled by this Court.

A. In the case of Warren v. King, 108 U. S. 389, decided by this Court in 1883, it was held that a holder of preferred stock in a corporation is not a creditor and is not entitled to the benefit of the security provided for in his stock certificate to the detriment of creditors. However, the Court did not in that opinion, except by inference, announce any test or rule for determining the question as to whether or not any particular contribution of money to a corporation constitutes the person advancing the money a creditor or a stockholder. This question has arisen in numerous cases under the income tax law in determining whether or not money paid by the taxpayer was dividends or interest. It has arisen in bankruptcy proceedings, where payments have been made by the bankrupt to a preferred stockholder on the theory that he was a creditor. It has also arisen in cases like the one under consideration here in determining the question as to whether or not a person advancing money to a corporation is a creditor and therefore entitled to the benefit of the security provided in his contract or a stockholder and therefore not entitled to the benefit of such security. The proper rule for determining this question has not been, but should be, settled by this Court.

B. In the case of Warren v. King, 108 U. S. 389, this Court, in holding that the owner of a certificate of preferred stock was not entitled as against creditors to the

benefit of the security provided in his stock certificate, assigned as reason (108 U. S., p. 399) the following:

> "His chance of gain, by the operation of the corporation, throws on him, as respects creditors, the entire risk of the loss of his share of the capital, which must go to satisfy the creditors in case of misfortune."

As a matter of necessary inference from this holding, it would follow that a person who merely advances money to a corporation under a contract which gives him no chance of gain from the operation of the corporation and only provides for the repayment of the money advanced with interest at the lawful rate specified is not in the position of a stockholder and is entitled to the benefit of whatever security his contract provides. The participating certificate set forth, supra (R. p. 22), provides for the payee no chance of gain from the operation of the corporation and only repayment of the money advanced with lawful interest. Therefore, the Court of Appeals, in holding that the payee or holder of the certificate occupies a position analogous to a stockholder, rendered a decision in conflict with the principle laid down by this Court in Warren v. King, 108 U. S. 389, and also in conflict with the decisions of various courts of appeals which have cited and followed the case of Warren v. King, as follows:

Hamlin v. Toledo, St. L. & K. C. R. Co., 78 F. 664 (C. C. A. 6);
Helvering, Commr. of Internal Revenue, v. Richmond F. & P. R. Co., 90 F. (2d) 971 (C. C. A. 4);
Commissioner of Internal Revenue v. O. P. P. Holding Corp., 76 F. (2d) 11, 12 (C. C. A. 2);
Isaacs v. Neece, 75 F. (2d) 566, 568 (C. C. A. 5);
In Re Lathrap, 61 F. (2d) 37.

II.

In the case of any new insurance company the cost of getting business for a time exceeds the premiums received from the holders of policies. Neither the capital stock nor the reserve fund set aside for the benefit of policyholders can be encroached upon for the purpose of paying these expenses of getting new business and, if the reserve is so encroached upon, it must be restored. Otherwise the company is deemed insolvent. In this case the corporation had thirty-two million dollars of insurance in force and more than twenty-seven thousand policyholders (R. p. 169). It had a right to pledge the future earnings or savings and profits of that business for the purpose of restoring an impairment in its reserve or to secure money to carry on the business. The validity of such pledges has been recognized by a number of courts in various cases, but has never been passed on by this Court. The question of the validity of such contracts is an important question of general law which should be settled by this Court. The validity of such contracts was upheld in:

Kingston v. Home Life Ins. Co. of America (Del.), 101 Atl. 898, 11 Del. Chancery Reports 258, affirmed 104 Atl. 25, 11 Del. Chancery Reports 428;

General American Life Ins. Co. v. Roach (Okla.), 65 Pac. (2d) 458, 179 Okla. 301;

Sherman v. International Life Ins. Co., 236 S. W. 634, 291 Mo. 139;

Jacobs v. Wisconsin National Bank (Wis.), 156 N. W. 159, 162 Wis. 318.

III.

The opinion of the court below establishes an unjust and inequitable result in that it denies to the payee of this certificate the right to recover $300,000.00 which was in good faith paid to the insurance company and applied by it in

restoring its impaired reserve for the benefit of policyholders, although the recovery is sought by this claimant not out of the reserve, not out of general assets, but merely out of savings and profits of the reinsured business which, under the contract with the Federal Reserve were to be applied to the repayment of this money. It is not equitable for the policyholders of the Federal Reserve to receive the benefit of this $300,000.00 and after insolvency also receive the benefit of the security which was pledged for its repayment, to wit, the savings and profits of the reinsured business as administered by the reinsuring company.

IV.

One does not become a stockholder merely because his contribution to the corporation is payable out of future earnings.

Ketchum v. St. Louis, 101 U. S. 306;
Stone v. Wright, 75 F. (2d) 457 (C. C. A. 10).

PRAYER.

For the purpose of correcting the errors complained of and to the end that the rights of the petitioner may be determined in accordance with the law, your petitioner respectfully prays that a writ of certiorari be issued under the seal of this Court directed to the United States Circuit Court of Appeals for the Tenth Circuit, commanding it to certify and send to this Court on a day certain, to be therein designated, a full and complete transcript of the records and proceedings of the said Circuit Court of Appeals in the within described cause of International Company of St. Louis, a corporation, appellant, v. E. R. Sloan, Receiver of The Federal Reserve Life Insurance Company, a corporation, and Occidental Life Insurance Company, a corporation, appellees, No. 2006, in equity, to the end that

the judgment of said Circuit Court of Appeals in said cause may be reviewed by this Court as provided by law, and that your petitioner may have such other relief as to this Court may seem appropriate, and that the judgment of the said Circuit Court of Appeals may be reviewed by this Honorable Court.

INTERNATIONAL COMPANY OF ST. LOUIS,
Petitioner,
By WILLIAM L. MASON,
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